DOW THEORY LETTERS INC.

RICHARD RUSSELL
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San Diego, Calif. 92115

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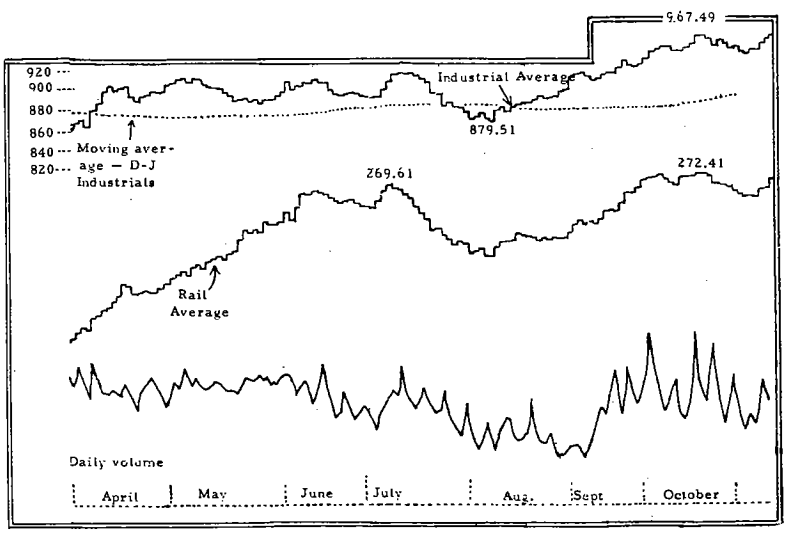
THE MARKET: Richard Nixon is in; Spiro Agnew is there with him. A Democrat-controlled Congress completes the bill. The Vietnam war continues without American bombing of the North. The economy races on despite social upheavals in the U. S. structure which are vaster and more violent than anything seen in a generation.

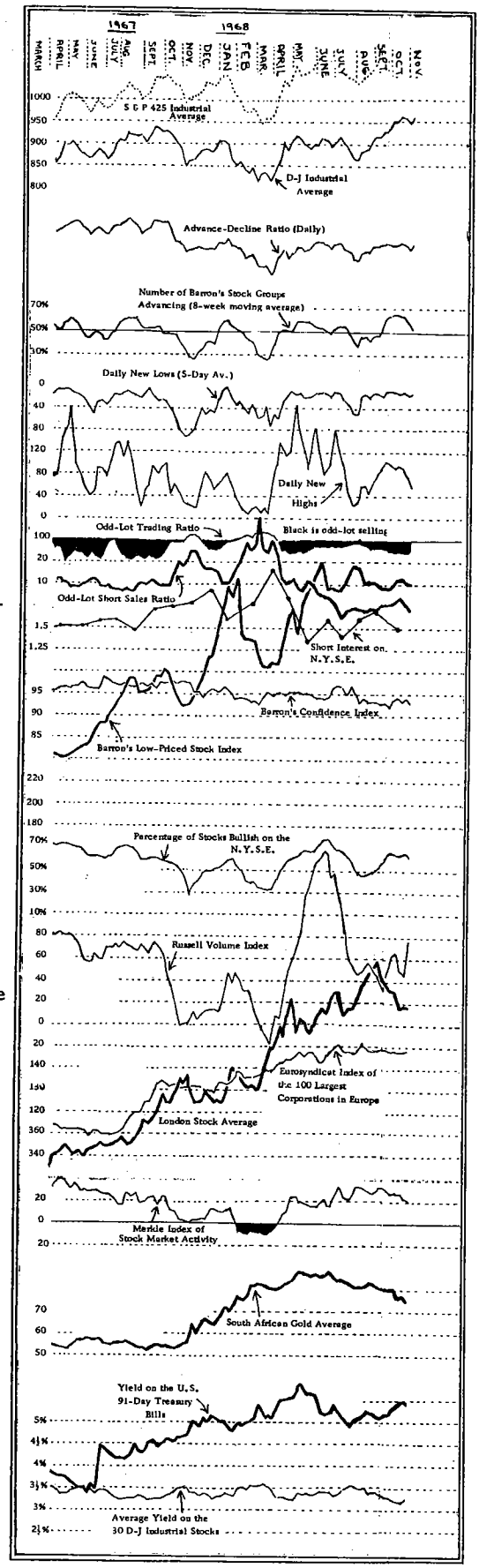
Since 1966 when the bull market topped out at 995.15 on the Dow, each year seems to be more exciting, more unbelievable than the last. As I see it (as my insides feel it, I should say), it all appears to be building up to an emotional crescendo, and I would bet that 1969 will be the year of the climax.

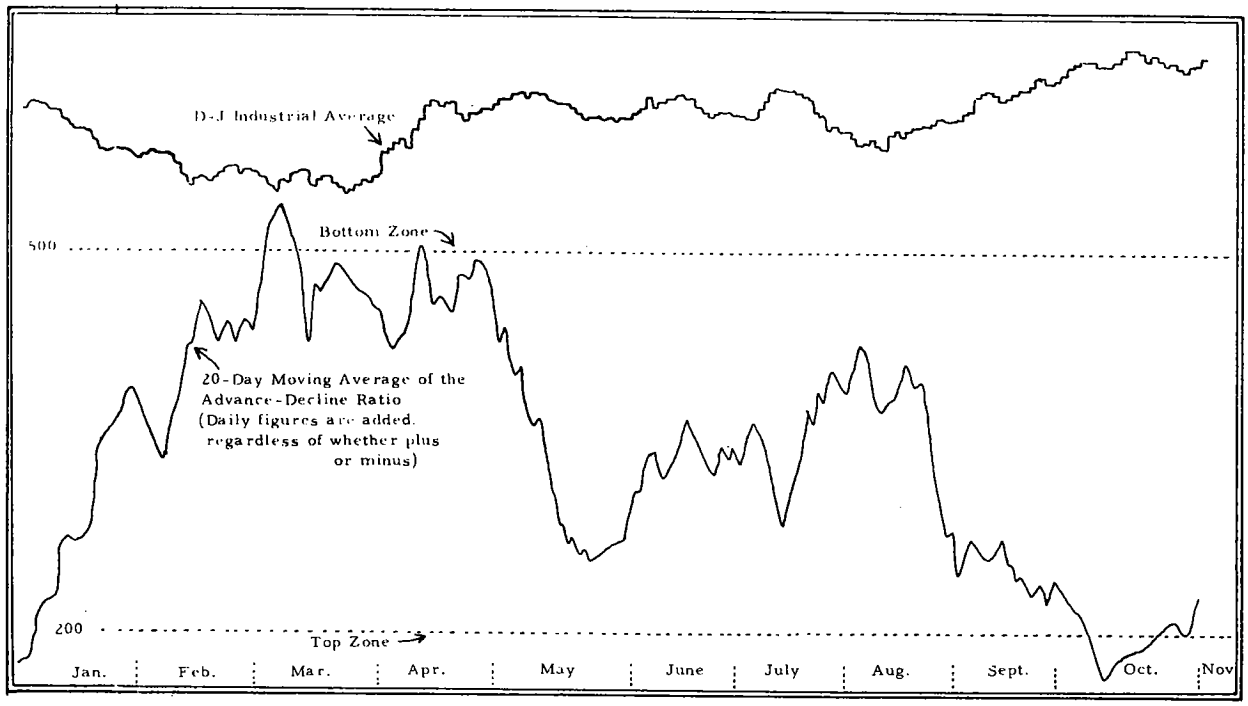
The climax could be total in extent. For never have so many divers forces converged on this nation. In ferment is the monetary situation, the debt picture, the velocity of check transactions in New York, stock volume, the racial situation, the whole youth movement, the mid-East, Asia.

It could well be that Americans elected Nixon because he represents stability, the old values, the structured old order, a glimpse of semi-conservative sanity. Humphrey somehow suggested the pseudo-hysteria of the 1930's, Wallace gave off ominous vibrations from the 1940's, while Nixon hints of President Eisenhower's comfort and sanity of the 1950's. Amid the confusion and violence and social upheavals of the late 1960's, it seems to me that the American people have elected the man they most trust to hold up the apple-cart. Humphrey wanted to do too much, and people are already suffering from "too much-itus." "Let Nixon just hold the fort," is what I hear people saying. "Let Congress just hold the fort. Give us a rest at high-level with prosperity and peace."

Meanwhile, the stock market is fulfilling its function of "feeling" its way ahead. The Dow Industrial Average is currently a few percentage points above its high of August, 1967, while the Rails are hovering just under their high of August, 1967. It has actually been a conservative performance on the part of the Averages. For over a year they have not really made any




1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Stock Groups Advancing (8-week moving average)
Daily New Lows (5-Day Av.)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Sales Ratio
Short Interest on N.Y.S.E.
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of Stocks Bullish on the N.Y.S.E.
Russell Volume Index
Eurosyndicat Index of the 100 Largest Corporations in Europe
London Stock Average
Merkle Index of Stock Market Activity
South African Gold Average
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks



substantial progress one way or the other. They have not collapsed in anticipation of major trouble ahead. They have not boomed in anticipation of a glowing 1968 and 1969. At the same time, it is a fact that fewer and fewer individual stock issues have participated in the 1968 advance and that "churning" has become apparent in the market. Perhaps the best way to illustrate this churning phenomenon is by a special study which I have shown above.

This chart, in principle, has been borrowed from a study which Paul Dysart (of the Trendway service) has been running for many years. During a market advance, it is characteristic for fewer and fewer stocks to participate, so that finally in a top area there will be great churning, with perhaps as many stocks advancing each day as declining each day. When a downward correction occurs, the opposite effect is seen. As the market heads down, more and more stocks participate in the decline until near the bottom we will witness what is termed a selling climax with perhaps 180 stocks advancing and 1000 declining on a single day or a series of days.

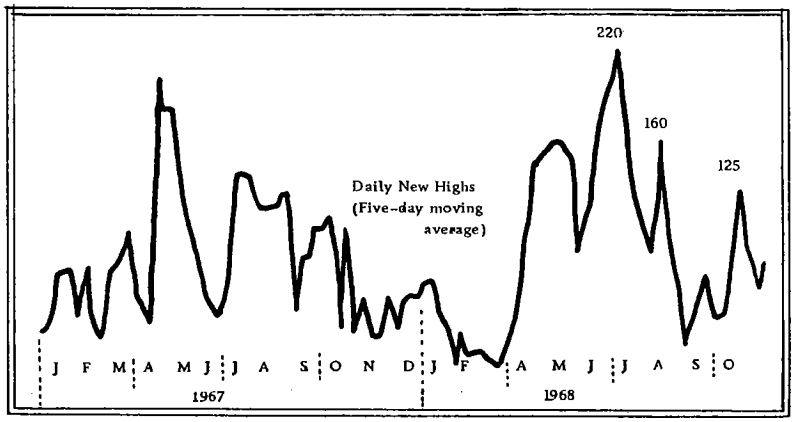
In other words, near a selling climax-bottom the opposite of churning is seen as almost everything on the Board goes down. Few people are aware of this very characteristic market phenomenon of huge movement at or near the bottom of a decline and little or no movement at or near the top of an advance. It might also be noted that tops are usually more extended and "tricky" while bottoms are sharp and sudden and more easily identifiable.

The chart above shows the D-J Industrial Average superimposed on a 20-day moving average of the advance-decline ratio. No notice is taken of whether the A-D ratio is plus or minus on any day. The A-D figures are merely added as a 20-day moving average, and this total shows the movement in the A-D figures over any 20-day period. Thus, theoretically, if total churning occurred at a top and there were twenty consecutive days of exactly as many advances as declines, the 20-day moving average would drop to zero. In practice, however, I would say that bottoms occur at around 500 on the 20-day moving average while tops may be looked for when the 20-day average drops into the 200 area.

Studying the chart, we see that the 20-day average of advances and declines moved up during January, February and March of this year, at which time the market was bottoming out and preparing for an advance. The advance started at the end of March, and the upward movement has continued to the present.

Now note that since March-April the 20-day average has continued generally down, and during the last few weeks it has dropped into the 200 area or the area of tops. As a rule, once the 20-day average has entered the top area the next major or important move of the market will be down, and this is the position the market is in today. I will refer to this study from time to time (particularly when it is in a top or bottom area), but for the time being it is well to remember that the 20-day average is at its lowest point since last January, at which time the market was preparing to decline.

A number of other technical indicators which I watch are suggesting caution or weakness. The percentage of all N.Y.S.E. stocks holding above their 200-day moving averages dropped to 66% last week, down from 78% in October and down from last May's 86%. The percentage of Barron's stock groups advancing (8-week moving average) shown on the page 1 chart dropped to 53%, down from the October high of 66%. Also weak is the 5-day average of daily New Highs on the N.Y.S.E. (see chart in Letter 409). This has established descending peaks of 220 in June, 160 in August, 125 in October, and the New High index stands at about 60 at this writing.



STRAIN: The accompanying chart (courtesy of the Weekly Bond Buyer) traces the yield spread between the highest-grade corporate bonds (Aaa rated) and the broad Standard and Poor 500 Stock Average.

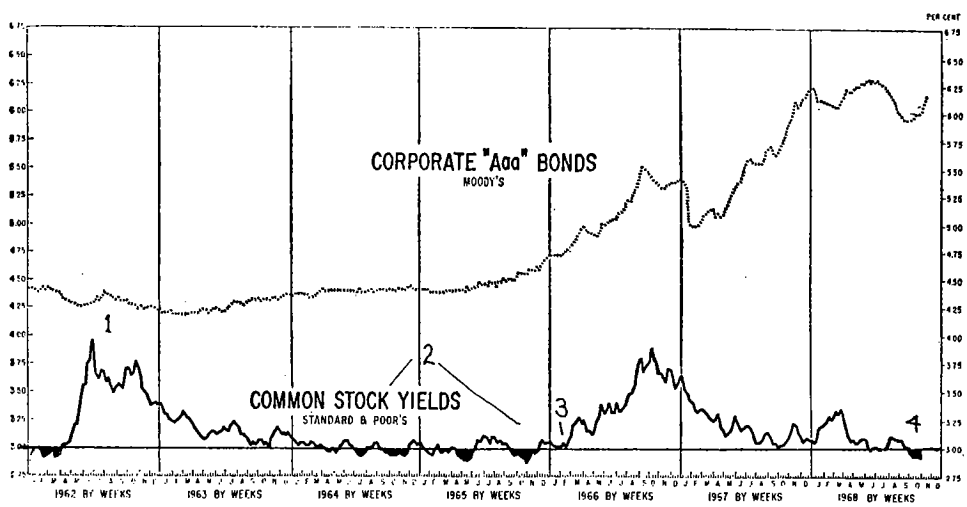
First let me say that the whole period shown on this chart (1962 to date) is quite unusual in financial history in that bond yields were higher than stock yields. This freakish relationship has endured since 1958 or for 19 years now. But during the last 50 years, there was only one comparable period and that was during the 1928-29 era, when for a brief time stock yields dropped below bond yields.

Studying the common stock yield line, we note that there have been two broad descents into the 3% area. The first followed the almost-4% yields in common stocks brought on by the 1962 crash, and this area I have marked #1 on the chart. This was followed by the steadily climbing bull market of 1963 and 1964. By mid-1964 yields on common stocks had dropped into the dangerous 3% and below zone, marked #2 on chart. By the end of 1965, with stock yields in dangerous territory and bond yields climbing steadily higher, the strain became unbearable.

By August, 1965, the inverse yield gap between stock and bond yields had climbed to 146 points. By November the gap had increased to 164 points. The stock market responded by topping out in early 1966 (marked #3 on chart), and the ensuing decline in stocks pushed equity yields steadily higher. By October, stock yields had risen to 3.80% and bond yields were sinking lower.

Then followed another broad advance in stocks along with a persistent decline in stock yields. Five weeks ago average common stock yields sank below 5% for the first time since 1965. At the same time bond yields headed higher again. This produced a near record yield gap. Last week, with the yield on the S & P 55 at 3.92% and the yield on Aaa bonds at 6.13, a yield gap of 3.21 in favor of bonds was seen (#4 on chart). This was within a tiny fraction of the record 3.28 yield gap of last June (the 3.28 yield gap preceded the sharp correction of June-July).

Based on my records of the past, I have noted that the average time that yields on common stocks will hold below 3% is six weeks. Following that, a decline of undeterminate proportions can be expected. This is what occurred during early 1962, and during early 1966. But during both of those instances bond yields were considerably lower than is now the case, and although the bond-stock yield spread was unfavorable, it was still under 2%.



The current situation is extraordinary. With common stock yields under the 3% level for the sixth week in a row, the inverse yield gap between bonds and stocks stands at a whopping 3.21 in favor of bonds. Thus I would

 say that the whole stock-bond yield relationship is now at its most unfavorable level in stock market history.

This unbelievably unfavorable relationship has undoubtedly been brought on by across the board speculative buying in common stocks in the face of a bond market that has been forced to its knees by inflationary fears.

The time is ripe for a major top in stocks, regardless of the way bonds go. The current 3.21 yield spread in favor of bonds over stocks in an extraordinary phenomenon and one which investors are likely never to see again in their lifetimes. Large investors can hardly ignore the relative attractiveness of top-rated bonds vs. stocks in this area. The only justification at this time for buying stocks over bonds is the faith that speculation will continue unabated while bonds continue to decline. Personally, I can conceive of bonds declining even further, but it is difficult for me to believe that any decline in bonds from here will not affect the stock market. Therefore, I can only conclude that the current highly unfavorable bond-stock yield gap is placing brakes on the stock market, and that a decline in stock prices is now imminent.

FOUR DECADES OF DEFICIT FINANCING: During the dark days of the 1930's, the days of the Great Depression, the U.S. discovered deficit financing. From the $16 billion national debt of 1929, this nation has continued to borrow (through good times and bad) until the national debt is now at its towering height of well over $300 billion dollars. This figure, of course, does not include the surging debt assumed since the 1930's by the consumer, the cities, the counties, and the states.

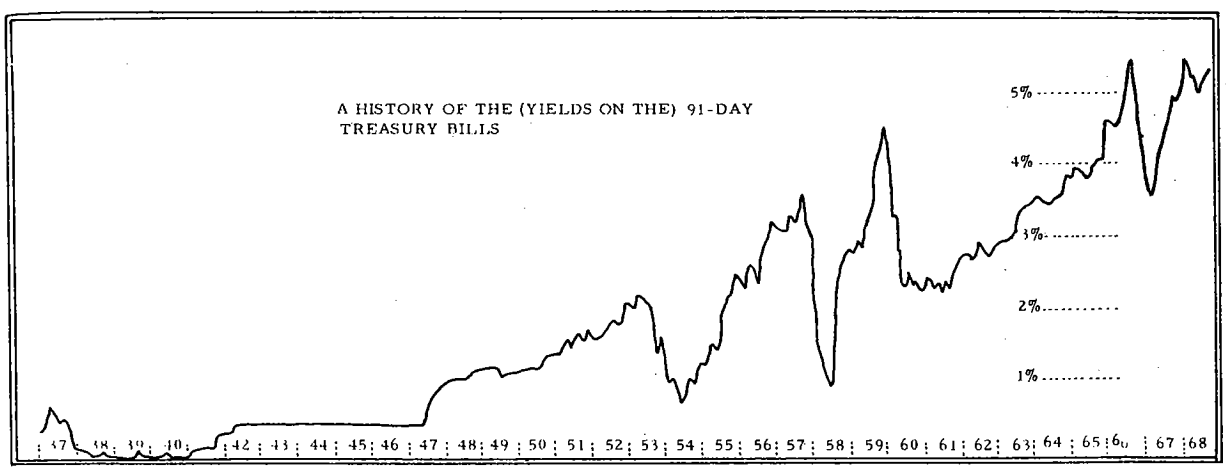
Last week William F. Helmuth, Jr., Deputy Assistant Secretary of the Treasury for Tax Policy stated in a speech, "Let me emphasize that regardless of who the next President is, the pressures on the Federal budget are enormous, almost irreversible, and they will continue to grow. This is a fact of our political economy which no President and no Congress can ignore.

"At home, the traditional claimants on the budget besides the military—the farmers, the veterans, beneficiaries from public works—have been joined in recent years by new and powerful claimants for the aged, for education, for health, and perhaps the poor and the disadvantaged who are still in the process of developing their political muscle."

The growth of all this built-in demand for money can be charted very effectively by taking the "blood-pressure" of the short term money market. This blood-pressure is the cost of short-term money (i.e., yields) on the bellwether of the short-term money market, the 91-day U.S. Treasury bill.

Without going into tedious detail, I ask subscribers to study the accompanying chart which shows the path of the yields on 91-day Treasury bills from 1927 (when they were first brought out) to the present.

Two major factors have pushed up these interest rates to their present near-historic high. The first is the steady movement of the U.S. national debt from long-term into short-term. This movement has come basically, because investors have been increasingly hesitant to tie up their money in slowly depreciating long-term U.S. bonds. Of necessity, as inflation continued, investors have favored short-term debt instruments, and this means bills (maturities of one year or under) or notes (maturities of one to five years) rather than bonds (maturities of five years or more). The second reason is simply supply and demand. As the public became aware of inflation and the preferability of stocks over bonds, they were less and less willing to put their money into the debt market. All the while the demand for money was expanding, and the cost of money can be measured by interest rates. Stated very simply, the less the desire for debt (which bear a fixed rate of return), the greater the cost to borrowers.



Many older subscribers remember the 1930's and 1940's when savings banks were paying interest rates of 2% while blue-chip stocks were yielding 6% to 8% (while going begging). Now the situation is reversed. Money can get 5.5% yield at short term, up to 7% at long-term, and yields on blue-chip stocks have dropped to the 3% area. What has happened? Demand has changed; everyone wants to put his money into stocks while no one wants to place money in fixed-interest debt. Borrowers are paying "through the nose" at around the highest levels in history while new borrowers line up with new issues of bonds.

This section was not written as an ominous prediction of "things to come." I would rather show subscribers "what is" and let them draw their own conclusions. The accompanying chart (page 4) seems to be telling its own story in its own time. And it is well to remember William Hamilton's warnings that "no tree grows to the sky." That admonition also includes interest rates. In my opinion, when interest rates do come down, it will be because everything else is coming down with them.

NOTES & QUOTES: Green's Commodity Market Comments (Nov. 6) is sceptical (as am I) regarding Johnson's bombing halt. They note that Hanoi prefers to think of the halt as a sort of unconditional surrender. "Yet we concur," says Green, "that the bombing halt was a risk well measured and worth taking to test the Communists' intentions. Because, make no mistake, that is all the bombing halt is. No more and no less, just a test of their intentions, not a breakthrough as heralded by some newspapers."

* * * *

In another section Green opines that the weakness in silver is essentially over. "We believe," says Green, "that the current (silver) move will culminate at new peaks in less than a year's time."

In line with silver, I note that the dollar price of gold in London (October 12) reached $39.62, highest price since early October. Should gold go to $39.90, it would be in position to test its last important peak at $40.00. Bettering $40.00, gold could be in position to test its high for the year at $42.40.

* * * *

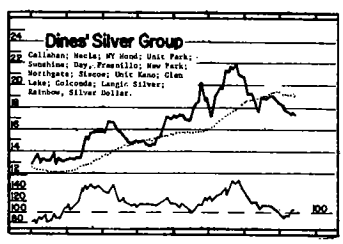
Reviewing the implications of the election, economist Eliot Janeway notes that a Republican Nixon potentially immobilized by a Democratic Congress is hardly a happy situation for Wall Street. States Janeway (Janeway Service, Oct.7): "This impressive ability of the New York market to perform in the face of pressures building up against it with the rise in money rates and the fall in profit margins has, in our judgment, reflected the heretofore plausible faith that Washington would provide — as, in fact, it has through all the near-misses of recent disturbances and crises. But, from this week on, the governmental capacity to lift and support the market is immobilized. And immobilized it is certain to remain throughout the next four years. It seems to us that a careful reassessment of bullish expectations is urgently in order."

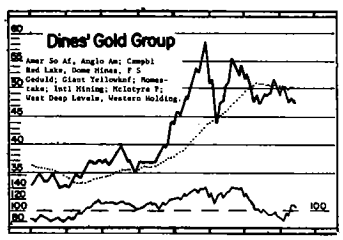
* * * *

Writing on November 9, E. George Schaefer says, "Today, of course, we have a near-classic background for a severe market drop; the speculative element is in full command as sophisticated investors have, in large measure, pulled into defensive position, and bullishness is as rampant as it is without firm foundation. Meanwhile, however, the technical position continues to erode quietly and the market becomes increasingly vulnerable to an almost limitless series of critical problems — domestic and international, political, social and economic — a sudden development in any one of which could trigger a runaway market collapse."

* * * *

Jim Dines (Dines Letter, Nov. 8) notes that "two important negative factors popped up this week. The first was an improvement in the Momentum Index for gold and silver shares; notice in both cases they have moved above the 100 line which is a bullish signal" (see Dine's charts). Second, Dines notes that odd-lotters have been selling less.





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Latest in the Vietnam peace-negotiations puzzle is that the U.S. warns Saigon that if it refuses to

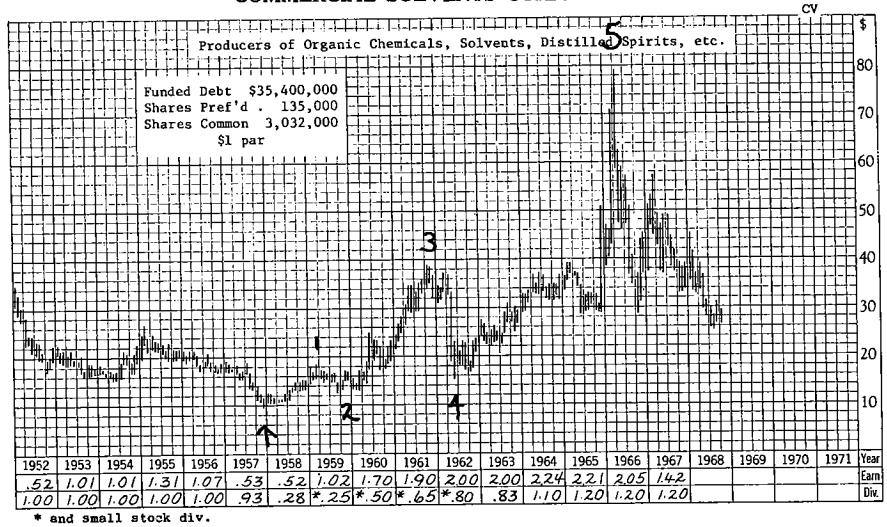
attend the conference, the U.S. will go it alone. In that case, all that can be settled is the U.S.'s military position in regard to Hanoi. What happens if the U.S. establishes a separate peace with Hanoi while Saigon remains in a state of war? No one seriously believes that Saigon would hold up long without U.S. help. Therefore, it seems to me that negotiations in Paris without Saigon put the whole Vietnam war back where it started, namely South Vietnam fighting a superior enemy from the North.

DOW THEORY MARKET LABORATORY PAGE

I have often referred to the Elliot Wave Principle, a theory of pattern which Elliot believed had a basis in the very nature of things. Elliot noted that a great many upward movements could be divided into five waves (three waves up known as the 1, 3 and 5 waves and two waves down known as the 2 and 4 waves). Converseley, down movements could be divided into three waves (wave 1 and 3 down and wave 2 up).

In my own experience, this type of action is seen too often to be discounted as mere chance. Often the Elliot movements can be seen best on long-term monthly charts such as the two below (courtesy of M.C. Horsey, 37 Wall Street, N.Y.C.).

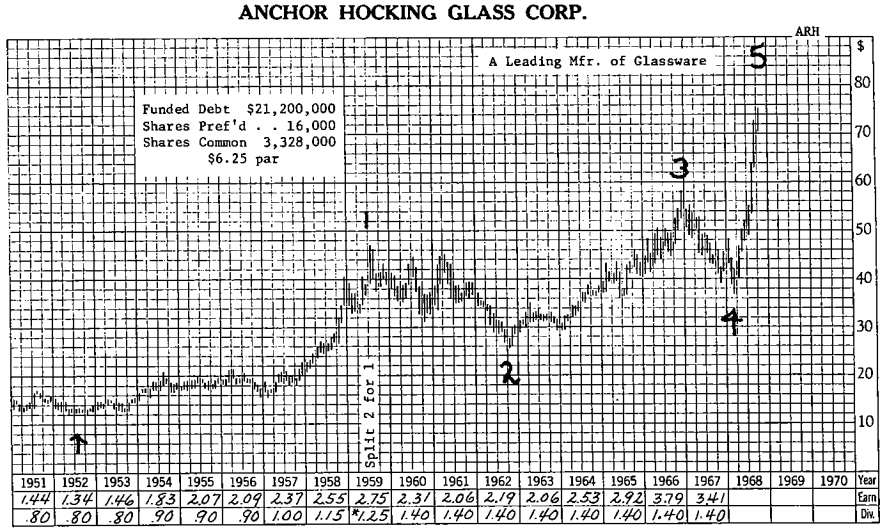
COMMERCIAL SOLVENTS CORP. ★


CV
Producers of Organic Chemicals, Solvents, Distilled Spirits, etc.
Funded Debt $35,400,000
Shares Pref'd . 135,000
Shares Common 3,032,000
$1 par
1 2 3 4 5
$ 80 70 60 50 40 30 20 10

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	
Earn	.52	1.01	1.01	1.31	1.07	.53	.52	1.02	1.70	1.90	2.00	2.00	2.24	2.21	2.05	1.42					Year
Div.	1.00	1.00	1.00	1.00	1.00	.93	.28	*.25	*.50	*.65	*.80	.83	1.10	1.20	1.20	1.20					

* and small stock div.

ANCHOR HOCKING GLASS CORP.


ARH
A Leading Mfr. of Glassware
Funded Debt $21,200,000
Shares Pref'd . . 16,000
Shares Common 3,328,000
$6.25 par
Split 2 for 1
1 2 3 4 5
$ 80 70 60 50 40 30 20 10

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	
Earn	1.44	1.34	1.46	1.83	2.07	2.09	2.37	2.55	2.75	2.37	2.06	2.19	2.06	2.53	2.92	3.79	3.41				Year
Div.	.80	.80	.80	.90	.90	.90	1.00	1.15	*1.25	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40				

On Anchor Hocking we see a long wave 1 and a complicated correction or wave 2. Usually if corrective wave 2 is complicated, the wave 4 correction can be expected to be simple and if wave 2 is simple wave 4 will be complex. To continue, upward wave 3 took ARH to the 1966 high, whereupon a simple wave 4 correction was seen. Wave 5 up is now in progress and as Elliot observed, the last or 5 wave is likely to be the speculative one. There is little doubt of the speculative intensity of the current wave 5 in ARH.

Commercial Solvents produced a wave 1 up starting in 1957. The 2 corrective wave was rather complex. A wave 3 up took CV to the 1961 high, and a simple corrective wave 4 plunged CV to the 1962 low. The final wave 5 started out conservatively enough, but after backing off in 1965, wave 5 ended with a typical wild speculative explosion. Following wave 5 CV entered into a major bear market, and between 1966 CV dropped from 79 to the mid-20's.

This study is particularly interesting since it shows two stocks currently at very different stages of their cycle, one in the (probable) final blow-off stage and one in a major bear market collapse.